B5350-24

The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

MONDAY, JULY 23, 1984 VOLUME XXI, NUMBER 27

Fears Of Either Rapid Inflation . . .

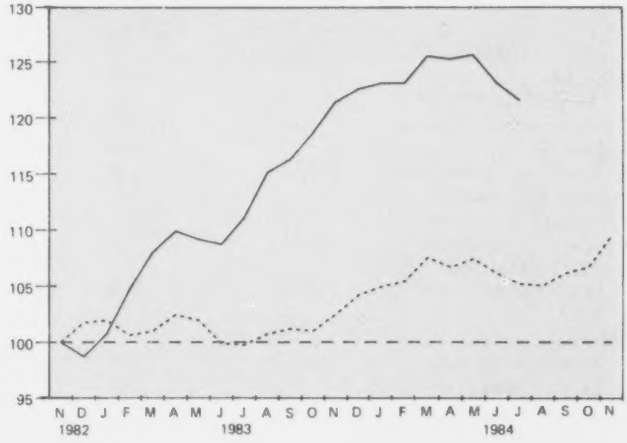
With the release of the Labor Department's report showing that producer prices in June remained unchanged for the third consecutive month, new concerns are developing in the financial markets. Besides longstanding fears of renewed double-digit inflation, there now are fears of deflation. Those who worry that inflation will race ahead believe that the economy is expanding so fast that it will soon run into shortages which will inevitably lead to higher prices. On the other hand, those concerned with deflation point to falling prices of raw industrial commodities, the soaring value of the dollar in the foreign exchange markets, and to the sharp drop in the price of gold as portending a period of actual declines in prices, with its attendant consequences.

These opposing views of escalating inflation and deflation stand in sharp contrast with the placid behavior of the major price measures. During the latest 12 months, producer prices advanced by 2.2 percent, while consumer prices were rising 4.2 percent. Meanwhile, the Commerce Department has also reported that the implicit GNP deflator—the broadest measure of inflation—is believed to have risen at a seasonally adjusted annual rate of 2.8 percent in 1984's second quarter.

A number of factors indicate that we are not on the verge of double-digit inflation. Most important, employers' wage bills are rising much more slowly in this economic expansion than they have, on average, in the past. Combined with increased productivity, labor costs per unit of output in many sectors of the economy are either flat or declining. Since labor costs comprise two-thirds of business costs, this trend alone portends moderate inflation.

Another important part of production costs—energy—has been declining. Surprisingly, the conflict in the Persian Gulf has pushed oil prices down in spot markets because some members of OPEC have decided that these hostilities have relieved them from adhering to their production quotas, thus allowing an increase in output. As a result, gasoline prices today are, on average, more than seven cents below their year-ago levels. Moreover, the combination of increased non-OPEC sources of oil, energy substitution and conservation efforts has reduced the dominance of OPEC in international markets and weakened significantly OPEC's ability to dictate world oil prices.

TUESDAY SPOT PRICE INDEX – RAW INDUSTRIALS
CURRENT RECOVERY (LINE), AVG. OF 3 PREVIOUS RECOVERIES (DOT)
(TROUGH=100)



The high value of the U.S. dollar has also subdued the rate of inflation. The Federal Reserve estimates that, all other things being equal, a ten percent appreciation in the external value of the dollar reduces the rate of consumer price inflation by about 1½ points over two to three years. The strong dollar, which now stands 66 percent above its trade-weighted value of mid-1980, has profoundly affected both business and labor in the U.S. It has opened markets previously closed to foreign competition, while at the same time, resulting in a shrinkage of our exports. This overabundance of goods in the U.S. has reduced the ability on the part of many U.S. companies to raise their selling prices—not to mention labor's ability to hike wages.

. . . Or Deflation . . .

On the other hand, recent declines in spot commodity prices and of gold have evoked fears of deflation. In turn, this has led to calls for the Federal Reserve to loosen its grip on money and credit. However, deflation, defined as a fall in the general price level, is usually associated with a *contraction* of the supply of money and credit.

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Such a drop in prices is generally accompanied by falling levels of output and increasing unemployment; it tends to take place in the declining stage of the business cycle.

The current economic environment does not give any credence to the deflationary thesis, at least not in the textbook sense. In the last year and a half, real GNP has grown at the fastest rate in the postwar era, pushed by record rates of fiscal and monetary stimulus.

The fears of deflation apparently were spurred by recent declines in basic commodities prices. Since their latest peak reached in mid-May, prices of these sensitive materials have fallen nearly four percent. Although they usually rise during economic recoveries, these commodities also tend to be volatile, and declines in the overall index are not unusual even in a period of strong economic growth (see chart on page 1). In the expansion following the 1973-75 recession, for example, raw industrial prices declined seven percent between July and November, 1976, resumed their climb—and then fell ten percent in the period between March and November, 1977. Currently, raw industrial prices are still more than 24 percent above their low point reached at the end of the last recession. Their recent decline has erased only one-eighth of the gain posted since these prices bottomed out in December, 1982.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit	7/18/84		
U.S. Gov'ts and Agencies Owned Outright & RPs	162.596	– .593	+ 8.099
Loans to Depository Inst.	5.891	+ 1.067	+ 4.655
Float	.728	– 1.026	– .845
Total Reserve Bank Credit	177.960	– .866	+11.761
Treasury Deposits with Federal Reserve Banks	3.415	– 1.071	+ .106
Currency in Circulation	176.844	– .555	+14.507
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	115.622	+ .144	+ 4.911
	7/18/84		
Member Bank Reserves:			
Total Reserves Held	37.352	+ .424	+ 1.549
Excess (Deficiency)	.455	– .603	+ .129
Net Borrowed Reserves	.077	+ .258	– .194
		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates†			
M1 (7/9/84)	546.2	+ 7.0‡	+ 6.3‡
M2 (June '84)	2,271.5	+ 7.4	+ 7.3
M3 (June '84)	2,835.3	+ 10.1	+ 9.3
Domestic Nonfinancial Debt (1st Q'84)	5,406.0	+ 12.3	+ 12.0

†Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 7/20/84	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	9.60%	10.00%	10.40%
* Federal Agencies	10.95	11.46	12.85
* Project Notes–Taxfree (46% Taxable Equivalent)	10.19	10.74	12.41
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	11.30	11.45	11.60

‡Finance Company Paper–Prime

5- 14 days	10.80%
15- 29 days	10.95
30- 59 days	11.05
60- 89 days	10.90
90-179 days	10.80
180-239 days	10.50
240-270 days	10.50

‡* Bankers' Acceptances

Aug.	11.10%
Sep.	11.15
Oct.	11.25
Nov.	11.30
Dec.	11.35
Jan.	11.42

‡Industrial Paper–Prime

30- 89 days	11.10%
90-120 days	11.20

†Federal Funds Effective Rate 11.00%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'84	$ 3,550	$ 3,436	$ 3,172
Gross National Product (1972 Dollars)*	1st Q'84	$ 1,609	$ 1,573	$ 1,490
Percent Change, Annual Rate	1st Q'84	9.7	5.0	2.6
Change in Consumer Prices (new series)*	May '84	2.4%	6.0%	4.8%
Change in Producer Prices*	Jun '84n	0.0%	0.0%	4.8%
Civilian Employment (Thousands of Persons)†	Jun '84	105,748	105,288	100,743
Unemployment as % of Civilian Labor Force†	Jun '84	7.1%	7.5%	10.0%
Personal Income*	Jun '84n	$ 3,005	$ 2,981r	$ 2,734r
Leading Indicators Composite Index (1967=100)†	May '84	168.2	168.3	154.4
Industrial Production Index (1967=100) †	Jun '84n	163.6	162.8r	146.4
Net Change in Consumer Installment Credit †	May '84n	$ 10.23	$ 6.41	$ 2.27
U.S. Merchandise Trade Balance †	May '84	–$ 8.84	–$ 12.19	–$ 6.75
Plant and Equipment Expenditures*	3rd Q'84	$314.52(a)	$303.79(a)	$270.05
Private Housing Starts (Thousands of Units)*	Jun '84n	1,900	1,805r	1,743
New Construction Expenditures*	May '84	$ 310.4	$ 305.0	$ 254.9
Total Business Inventories †	May '84n	$ 545.9	$ 541.1r	$ 501.0
Total Business Sales †	May '84n	$ 412.3	$ 405.9r	$ 360.5

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

. . . Are Greatly Exaggerated

Several factors have contributed to the recent declines in commodities prices. On the demand side, the recoveries in Europe and Japan have so far been much more subdued than in the U.S., reducing their need for raw materials. In addition, the soaring dollar is cutting worldwide demand for commodities even further because the rest of the world has to pay more in local currencies for those internationally traded commodities that are priced in U.S. dollars. Moreover, the combination of high interest rates and low inflation rates has forced producers to keep their inventories lean as well as discouraged speculative buying. This obviously has depressed the demand for many commodities. Finally, developing countries seeking to step up their exports to earn funds with which to service their external debts are producing more commodities, thus depressing prices further.

As for the price of gold, which many consider a barometer of inflationary expectations, its decline reflects, in part, an optimistic outlook for inflation. In addition, high interest rates increase the opportunity cost of holding gold. Far from indicating deflation, the decline in gold prices reflects the sophistication of investors, moving into the many high-yielding financial asset alternatives currently available. H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (7/4/84)	155,980	– 871	+ 9,237
New York City (7/11/84)	34,582	– 263	+ 1,643
Commercial Paper (7/11/84)	222,122	+ 1,837	+49,689

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/4/84)	244,624	+ 1,033	+28,079
New York City (7/11/84)	64,278	– 549	+ 5,530

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/4/84)	619,625	+ 6,683	+91,423
New York City (7/11/84)	138,055	– 2,901	+18,909

Financial Markets

	Friday 7/20/84	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	10.53%	+ .11	+ 1.01
180-Day Bills†	11.24	+ .02	+ 1.32
Longest Bills†	11.94	– .16	+ 1.64
Recent Issues:			
13s 6/30/86	12.80	– .12	
13⅝s 6/30/88	13.10	– .16	
13⅛s 5/15/94	13.26	– .13	
13¼s 5/15/14	13.10	– .07	
Municipals:			
Bond Buyer–20 Bond Index* (7/19/84)	10.36%	– .06	+ .84
Blue List Total ($ Million)	$1,133	– $ 96	+ $ 86
30-Day Visible Supply ($ Million)	$1,834	+ $521	– $1,061
Total	$2,967	+ $425	– $ 975
Corporates:			
Moody's Aa Composite (7/19/84)	14.12%	– .06	+ 1.69
30-Day Visible Supply ($ Million)	$ 400	– $427	– $ 20
Stocks:			
Dow-Jones Averages:			
Industrials	1,101.37	– 8.50	– 129.80
Transportation	451.75	– 11.52	– 127.31
Utilities	123.70	– 2.07	– 7.80
65 Stocks	426.40	– 5.84	– 65.01
Standard and Poor's 500 Stocks	149.55	– 1.33	– 19.34
N.Y.S.E. Composite Index	86.21	– .87	– 11.53
N.Y.S.E. Avg. Daily Vol. for Week (000's)	79,648	– 334	– 5,042

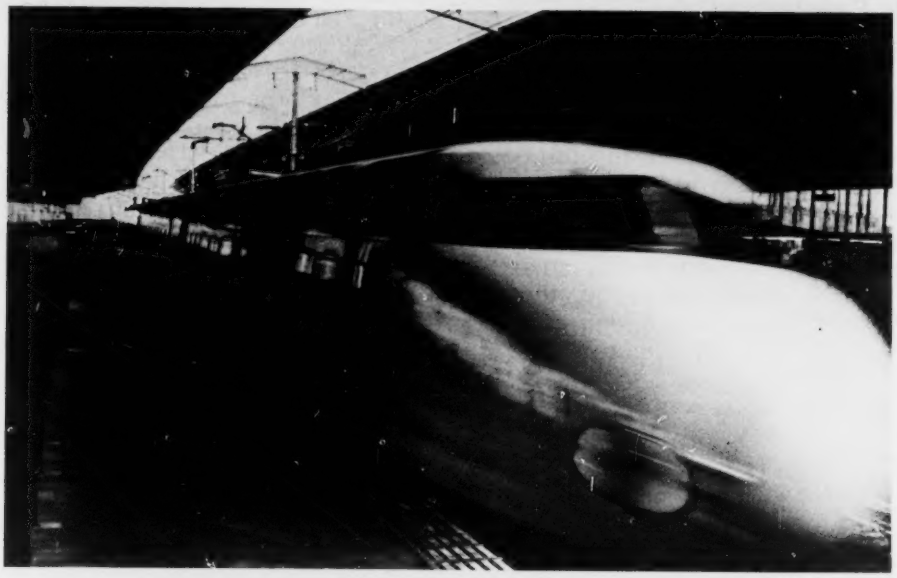
* 46% Taxable equivalent 19.19%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 7/20/84	Week Ago
Overnight	10.88%	10.19%
1 month	11.44	11.50
3 month	11.88	11.88
6 month	12.50	12.50
1 year	13.13	13.13
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	13.40%	13.50%
Long Term (7 to 15 yrs.)	13.70	13.70

FOREIGN EXCHANGE SPOT RATES New York Opening (7/20/84)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01735	57.64
Canada	.7521	1.3296
Denmark	.09615	10.4000
France	.1143	8.7525
Germany	.3503	2.8550
Italy	.0005709	1,751.50
Japan	.004092	244.35
Mexico	.005128	195.00
Netherlands	.3104	3.220
Switzerland	.4139	2.4160
U.K.	1.3238	.7554



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